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BEFORE THE  
POSTAL RATE COMMISSION  
WASHINGTON, DC 20268-0001

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CLASSIFICATION AND FEES FOR  
WEIGHT-AVERAGED, NONLETTER-SIZE  
BUSINESS REPLY MAIL, 1999

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DOCKET NO. MC99-2

DIRECT TESTIMONY  
OF  
JAMES M. KIEFER  
ON BEHALF OF  
UNITED STATES POSTAL SERVICE

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## **AUTOBIOGRAPHICAL SKETCH**

My name is James M. Kiefer. I am an Economist in the Office of Pricing, Marketing Systems, at the United States Postal Service. Since joining the Postal Service in 1998, I have worked on issues related to Special Standard and Library Mail, Special Services and nonletter-size Business Reply Mail.

Prior to joining the Postal Service I worked for the Vermont Department of Public Service, first as Power Cost Analyst, and later as Planning Econometrician, where I investigated utility costs, rates, load forecasts and long term plans. I also developed long range electric generation expansion plans for the State, performed economic impact studies, and contributed to a long-term energy use plan for Vermont. I have testified as an expert witness before the Vermont Public Service Board on many occasions on economic issues involving cost of power, generation expansion plans, least cost integrated planning, load forecasts, and electric utility rates.

Before working in Vermont, I was a Principal Analyst with the Congressional Budget Office. Past work experience also includes work with the U.S. Department of Commerce and work in production management in private industry.

I earned a BA in Chemistry from the Johns Hopkins University. In 1980 I earned an MBA from Rutgers University, and in 1981 an MA degree in International Relations from the Nitze School of Advanced International Studies. I then returned to Johns Hopkins in Baltimore to study Economics where I earned an MA in 1983 and a PhD in 1986.

My appearances in this docket and in Docket MC99-1 represent my first appearances before the Postal Rate Commission.

1   **I. Purpose of Testimony**

2       My testimony reports on the Postal Service's nonletter-size Business Reply  
3   Mail (BRM) experiment and proposes that the Postal Rate Commission  
4   recommend a permanent classification and fees for nonletter-size Business  
5   Reply Mail for which the Postal Service will perform the accounting function  
6   using a weight averaging methodology. My testimony discusses why a  
7   permanent classification should be established and shows how such a  
8   classification would meet the requirements for a new classification and fee  
9   changes outlined in 39 U.S.C. sections 3623(c) and 3622(b).

10

11   **II. Background**

12   **A. Processing Nonletter-size BRM.**

13       The Postal Service has offered Business Reply Mail (BRM) service since  
14   1958. For an annual fee, the Postal Service allows BRM recipients to offer their  
15   customers specially designed return mail envelopes and cards that the  
16   customers can mail without affixing postage. The Postal Service determines the  
17   postage due and bills the BRM recipient for the postage due, plus a per-piece  
18   fee to cover the cost of accounting.

19       As explained by USPS witness Rometta Shields (USPS-T-1), for nonletter-  
20   size BRM the standard Postal Service practice is to manually count, weigh, and  
21   rate each piece. For large volume recipients of nonletter-size BRM, this piece-  
22   by-piece determination of postage due requires considerable postal time and  
23   labor. It often prolongs the time recipients of large volumes have to wait before

1 receiving their BRM.<sup>1</sup> Because it is time consuming to calculate the postage and  
2 fees for recipients of large volumes of nonletter-size BRM, it made sense  
3 operationally for the Postal Service to work with BRM recipients to explore  
4 streamlining the standard, piece-by-piece approach to calculating postage and  
5 fees. Two methods evolved as alternatives to piece-by-piece accounting: weight  
6 averaging and reverse manifesting.

7

8 *Weight averaging.* Under the weight averaging approach, Postal Service  
9 personnel weigh each customer's incoming BRM in bulk and then apply a  
10 conversion factor to estimate postage due from mail weight. The Postal Service  
11 periodically samples each customer's BRM mailstream to update the conversion  
12 factor. For a more detailed description of this method, please see the Docket  
13 No. MC99-2 testimony of USPS witnesses Rometta Shields (USPS-T-1) and  
14 Leslie Schenk (USPS-T-3).

15

16 *Reverse manifesting.* With reverse manifesting, the BRM recipient uses its own  
17 business processes to generate an incoming mail manifest and to calculate  
18 postage due. The Postal Service audits the manifests regularly to ensure that  
19 they contain all incoming mail pieces and accurately calculate postage due. For  
20 a more detailed description of the reverse manifesting method, see the testimony  
21 of USPS witness DeMay in Docket No. MC97-1 (USPS-T-1).

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<sup>1</sup> Currently, the Postal Service charges a per piece accounting fee of eight cents for those businesses maintaining an advance deposit account to pay postage due. The fee for those who do not use the advance deposit account is 30 cents per piece. The account requires an Accounting Fee of \$300 per year, so recipients with all but the smallest volumes of BRM should

1

2 **B. Purpose of the Nonletter-Size BRM Experiment.**

3 In Docket MC97-1, the Postal Service requested that the Commission  
4 recommend two experimental classifications for nonletter-size BRM, one using  
5 weight averaging and one using reverse manifesting. The Postal Service had  
6 several purposes in proposing the experiment:

7

- 8 • to explore ways to reduce the cost of nonletter-size BRM accounting;
- 9
- 10 • to find out if it is feasible and practical to offer lower fees to nonletter-
- 11 size BRM recipients who use the reverse manifesting and weight
- 12 averaging accounting methods;
- 13
- 14 • to speed up the release of this mail to customers;
- 15
- 16 • to determine appropriate operational procedures that would ensure the
- 17 accuracy of postage and fees calculations under these alternative
- 18 methodologies.
- 19

20 In its Docket No. MC97-1 Opinion, the Commission recommended the  
21 establishment of these experimental classifications for a period of two years.  
22 Following the Governors' approval, the experiment began in June of 1997 and is  
23 scheduled to expire June 7, 1999.<sup>2</sup>

24

25 *Criteria for selection of Docket No. MC97-1 experiment participants.* The Postal  
26 Service's plan for the experiment allowed for participation by up to twenty  
27 participants, as many as ten for each of the two experimental accounting

---

find it advantageous to set up and maintain advanced deposit accounts. See DMCS Fee Schedule 931.



1 methodologies. The Postal Service specified a number of factors to be  
2 considered in selecting the candidates for the experiment:

- 3
- 4 • participants should come from a variety of industries;
- 5
- 6 • participants should receive a sufficiently large volume of nonletter-size
- 7 BRM at one location;
- 8
- 9 • participants' mail should exhibit some variability in piece weights and
- 10 daily volumes;
- 11
- 12 • participants should be willing to stay in the experiment for at least a full
- 13 year.
- 14

15 *Recruitment of experiment participants.* The Postal Service attempted to identify  
16 and recruit participants for the experiment during a period that ran from June  
17 1997 to January 1998. The Postal Service employed two different strategies,  
18 one that targeted mailers individually and one that reached out to the general  
19 mailer population. With the targeted approach, the Postal Service focused on  
20 contacting mailers who appeared to have a high enough volume of nonletter-size  
21 BRM to justify paying the required startup and monthly fees. These mailers  
22 included medical laboratories, medical supply houses, film processors, and  
23 market researchers. The other approach publicized the experiment in various  
24 media read by the mailer community, as discussed below.

25 Once the Postal Service identified potential participants, it attempted to  
26 recruit them using one or more of the following approaches:

27

---

<sup>2</sup> In a companion docket to this one, the Postal Service is requesting that the Commission recommend a renewal of one portion of the experiment until the implementation of a permanent classification and fees, or February 29, 2000, whichever comes first.

- 1       • Letters were sent to mailers identified in Postal Service databases as  
2       receiving Business Reply Mail heavier than two ounces per piece.
- 3       • A few mailers sent unsolicited letters to Postal Service headquarters or  
4       made telephone inquiries about the experiment. In each case, the  
5       Postal Service provided the mailer with full details about the  
6       experiment and invited it to participate.
- 7       • Articles about the experiment were placed in various media likely to  
8       get mailer attention. Details about the experiment were first published  
9       as a final rule in the May 9, 1997 *Federal Register* and in the May 22,  
10      1997 *Postal Bulletin*. Articles about the experiment also appeared in  
11      the June 1997 issue of *Mailers Companion*, and in the July 1997  
12      edition of *Memo to Mailers*.
- 13      • On several occasions the Postal Service sales force was also  
14      requested to assist with the identification of prospective candidates,  
15      based on their knowledge of the mailer population. These efforts also  
16      included distributing informative material about the experiment to  
17      Postal Service national account managers and account  
18      representatives who attended an August 1997 national meeting.  
19      Those in attendance were requested to use the information to  
20      approach any customer who received a large volume of nonletter-size  
21      BRM and encourage them to participate. In addition, as late as  
22      December 1997, the Postal Service compiled a further list of ten  
23      companies from the Postal Service's CBCIS database and asked the

1           appropriate field sales representative to contact the mailers to see if  
2           they were interested.

3           These recruitment efforts produced four companies willing to participate in  
4           the experiment, three using the weight averaging methodology and one using  
5           reverse manifesting. Notwithstanding the Postal Service's attempts to interest  
6           businesses from a broad cross section of industries, all four participants came  
7           from the through-the-mail film processing industry.

8

### 9   **III. Report on the Nonletter-Size BRM Experiment**

#### 10   **A. Implementing the Experiment.**

11           Following selection of the participants, the Postal Service inaugurated the  
12           weight averaging experiment at the Seattle, WA, New London, CT, and  
13           Washington, DC post offices, and the reverse manifesting experiment at the  
14           customer's facilities in Parkersburg, WV. The experiment has proceeded without  
15           major problems at the three weight averaging sites, but at the reverse  
16           manifesting site the experiment encountered several difficulties.

17

#### 18   **B. Problems with the Reverse Manifesting Experiment.**

19           The reverse manifesting experiment never fully lived up to the Postal  
20           Service's expectations. While there were no significant problems attributable to  
21           the methodology itself, or to the data collection portions of the experiment, the  
22           participant was unable to consistently estimate postage due with an acceptable

1 degree of accuracy.<sup>3</sup> The testimony of witness USPS DeMay in Docket No.  
2 MC97-1 (USPS-T-1) provides a detailed description of this problem and explains  
3 the main sources of the errors. Although witness DeMay's account describes  
4 conditions that preceded the experiment, the accuracy problem continued during  
5 the entire experimental period itself.

6 Efforts to resolve this problem had not been successful when, in the middle  
7 of the experiment, the reverse manifesting participant was acquired by one of the  
8 companies participating in the weight averaging part of the experiment.  
9 Following the acquisition, the acquiring company's management decided to  
10 switch its new subsidiary to weight averaging. The loss of the sole participant  
11 effectively terminated the reverse manifesting portion of the experiment before  
12 further work to improve its application could be completed.

13 Thus, the Postal Service has decided not to request a permanent  
14 classification for the reverse manifest method. Several factors contributed to this  
15 decision:

- 16 • Despite our efforts to find nonletter-size BRM recipients interested in  
17 the methodology, we only found one participant for the reverse  
18 manifesting experiment.
- 19 • Moreover, as explained by USPS witness Ellard (USPS-T-2), our  
20 subsequent market research did not find *any* potential customers  
21 interested in a reverse manifesting permanent classification.

---

<sup>3</sup> One of the goals of the reverse manifesting experiment was to calculate postage and fees to within a  $\pm 1.5$  percent level of precision on a daily basis.

- Additionally, even after more than a year in the experiment, the sole reverse manifesting participant failed to achieve the target level of accuracy when estimating postage due. Thus, we were unable to confirm the viability of the method.

### **C. Data Collection Plan.**

The request for the experiment in Docket No. MC97-1 contained a Data Collection Plan (Docket No. MC97-1, USPS-T-3, Appendix B) having two purposes: to measure the effectiveness of the experiment, and to collect data to support a request for permanent classifications, should the experiment prove successful. Our plan envisioned collecting operational and cost data and marketing data.

*Operational and cost data.* The plan called for the Postal Service to collect data on the costs of setting up and operating the experimental methodologies, on the volumes of BRM participating, and on the characteristics of the mailpieces received by the participants. USPS witness Leslie Schenk oversaw the collection of operations-related data. Her Docket No. MC99-2 testimony (USPS-T-3) describes her data collection efforts in greater detail.

As indicated in Dr. Schenk's Docket No. MC99-2 testimony, the information collected during the operational data collection phase supports her monthly sampling and per-piece accounting cost estimates. I use these estimates to

1 develop my pricing proposals. I also use her accounting cost estimates to help  
2 produce my revenue and cost impact estimates.

3

4 *Market research data.* USPS witness Ellard conducted the market research  
5 called for by the Data Collection Plan. He developed this research to explore the  
6 level of interest in weight averaging and reverse manifesting over a likely range  
7 of fees, to identify other nonletter-size BRM recipients potentially interested in  
8 these accounting methods, and to find out what kind of nonletter-size mailpieces  
9 these customers might be receiving. Witness Ellard's testimony (USPS-T-2)  
10 provides the details of the research, including the methodology and results.

11 His market research produced a number of solid candidates for a permanent  
12 weight averaging classification, but none for reverse manifesting. The lack of  
13 market interest is a key factor in the Postal Service's decision not to request a  
14 permanent nonletter-size BRM classification based upon the reverse manifesting  
15 accounting method. In contrast, the research shows that interest exists for the  
16 weight averaging methodology and fee structure, supporting our request for a  
17 permanent classification. The information gathered by his market research also  
18 supports my revenue and cost impact analyses.

19

20 **D. Experimental Goals Met.**

21 The following discussion examines how well the weight averaging portion of  
22 the experiment has met the goals set out for it. In presenting its case for the

1 experiment, the Postal Service described the following five goals (Docket No.  
2 MC97-1, USPS-T-3 at 29):

- 3  
4 1. To determine whether the proposed fee structure properly reflects  
5 costs and whether a minimum volume requirement is needed.  
6
- 7 2. To find out whether it is feasible and practical to offer lower fees for  
8 nonletter-size BRM customers using the experimental methodologies.  
9
- 10 3. To gauge the type of BRM customer that is interested in these fees as  
11 well as the overall degree of interest.  
12
- 13 4. To collect data needed to assess the revenue impact of the BRM fee  
14 changes.  
15
- 16 5. To measure more precisely the costs of the two methodologies.  
17

18 Our experience confirms that the current weight averaging experiment is  
19 meeting its goals. Witness Schenk's testimony in this proceeding (USPS-T-3)  
20 presents the costs for the weight averaging methodology (Goal 5). Her study  
21 shows that the fees charged during the experiment more than cover ongoing  
22 costs. Indeed, the results of her study demonstrate that the permanent fees can  
23 be reduced from their experimental levels. In Sections IV and V of my testimony,  
24 I discuss my proposed fees in light of Dr. Schenk's new cost data, and also  
25 address the issue of a minimum volume requirement (Goal 1).

26 The cost data, as well as our operational experience (described in witness  
27 Shields' testimony (USPS-T-1)) both affirm the feasibility and practicality of  
28 offering lower fees to customers when the Postal Service utilizes weight  
29 averaging to process their nonletter-size BRM (Goal 2).

1       Witness Ellard's testimony describes our market research study and  
2       discusses the type and number of customers we have identified who have  
3       expressed interest in weight averaging (Goal 3). Together with witness Schenk's  
4       cost data, this market research enables the Postal Service to assess the revenue  
5       impact of implementing weight averaging technology and fees (Goal 4). I  
6       discuss this in further detail in Section VI of my testimony.

7

8       **E. Valuable Lessons Learned.**

9       The Postal Service's experience with the nonletter-size BRM experiment has  
10      confirmed the value of conducting an experiment to explore the demand, costs,  
11      and operational characteristics of a potential classification. This experiment has  
12      already provided and continues to provide the Postal Service with valuable  
13      experience that ultimately will help it to roll out a permanent service nationwide  
14      with a minimum of operational difficulties. Some of the lessons learned confirm  
15      our original notions; others have shown where changes in approach are  
16      warranted. The following summarizes some key lessons learned.

17

18      *Our understanding of sample sizes has been clarified.* Our experience with the  
19      weight averaging experiment has been very effective in refining our  
20      understanding of what standards should be set for sampling. Originally, postal  
21      personnel sampled about 5,000 pieces per accounting period. Witness Schenk's  
22      subsequent monitoring and analysis of experimental data showed that we could  
23      meet our  $\pm 1.5\%$  postage due accuracy target for the same mailstream by



1 sampling only about half as many pieces. Cutting the sampling time in half  
2 produces significant cost savings and justifies substantially lower monthly fees.  
3 Sections III.C and III.D of Dr. Schenk's testimony (USPS-T-3) discuss our  
4 conclusions regarding sample sizes in greater detail.

5  
6 *Our understanding of costs has improved.* Witness Schenk's observations also  
7 confirmed that, in the weight averaging methodology, only the bulk weighing  
8 costs have a significant volume variable component. Accounting and sampling  
9 appear to be largely unaffected by BRM volume. She discusses this topic in  
10 more detail in section IV.A of her testimony (USPS-T-3).

11 The experiment has also taught us that there is no compelling reason to treat  
12 setup costs differently than we do for other postal services. In Section V, I  
13 discuss several reasons why the Postal Service believes that charging a fee to  
14 recover setup costs, while appropriate in the experiment, should not be part of a  
15 permanent weight averaging classification.

16  
17 *Market research confirms no interest in reverse manifesting.* Our market  
18 research has provided us with evidence that there is no interest in establishing a  
19 permanent reverse manifesting classification. It also has suggested to us that  
20 customers whose volumes fall below the break-even point between the proposed  
21 weight averaging fee structure and the current eight-cent per piece accounting  
22 fee structure would not be interested in weight averaging, even if it holds out the  
23 potential of receiving their BRM earlier in the day.

1

2 *Some administrative and operational challenges need to be resolved.* The  
 3 experiment has revealed its value by pointing out areas where we need to  
 4 improve our weight averaging implementation and administration. For example,  
 5 a network-based sampling and postage calculation computer program may be  
 6 preferable for operational reasons to the original PC-based software. The  
 7 experiment has also shown us areas where we need to strengthen  
 8 communications between the field and those managing the implementation of  
 9 the weight averaging methodology to ensure a smooth roll-out nationwide.<sup>4</sup>

10

#### 11 **IV. Proposal**

12 The Postal Service requests that the Commission recommend a permanent  
 13 classification and fee structure for nonletter-size BRM that the Postal Service will  
 14 count, rate and bill using the weight averaging methodology. The Postal Service  
 15 proposes that BRM recipients who opt to have their nonletter-size BRM  
 16 accounted for under the new classification pay the following fees:

- |    |  |          |
|----|--|----------|
| 17 | • <b>Per Piece Fee</b>                   | \$0.01   |
| 18 | • <b>Monthly Sampling/Accounting Fee</b> | \$600.00 |

19 In addition to these fees, recipients will pay applicable First-Class or Priority  
 20 Mail postage on each piece of eligible nonletter-size BRM. Attached to my  
 21 testimony as Appendix A are the proposed changes to §931 of the Domestic  
 22 Mail Classification Schedule which would implement the permanent category of

---

<sup>4</sup> I discuss some of these operational problems and some potential solutions in more detail in Section III of my testimony in Docket MC99-1 (USPS-T-1, at 5-6).

weight-averaged nonletter-sized BRM. Attached to my testimony as Appendix B is the current Fee Schedule 931, amended to show these fee changes. BRM recipients who opt for the weight averaging method would still need to obtain a BRM permit annually (\$100 fee) and maintain an advance deposit account (\$300 fee per year) for accounting purposes. Table 1 below shows the proposed fees for the new weight averaging classification, along with the fees non-QBRM nonletter-size BRM would pay under the current fee structure and the fees now paid by BRM participating in the weight averaging experiment.

<b>Table 1</b> <b>Current and Proposed Fees Available to Nonletter-Size BRM</b> <b>(When an Advance Deposit Account is Used)</b>			
<u>Classification</u>	<u>Per-piece Fee</u>	<u>Monthly Fee</u>	<u>Setup Fee</u>
Current Non-QBRM Mail	\$0.08	None	None
Current Experimental Weight Averaging BRM Classification	\$0.03	\$3,000	\$3,000
Proposed Weight Averaging BRM Classification	\$0.01	\$600	None

The new classification will be open to BRM that consists of flats and parcels, as well as letters weighing more than two ounces, whose postage due is collected from an advance deposit account.<sup>5</sup> I will refer to BRM meeting the specifications throughout my testimony as nonletter-size BRM, since it consists

<sup>5</sup> Thus, by definition, it excludes all BRM which currently qualifies as QBRM (*Domestic Mail Manual*, Issue 54, §E150.1.1).

1 overwhelmingly of pieces which are not automation-compatible letters, but are  
2 generally too thick or otherwise too large to be defined as “letters.”

3 The Postal Service’s market research (USPS-T-2) suggests that a broad  
4 range of organizations receive nonletter-size BRM. Common examples include  
5 companies that offer film processing by mail, state disability and rehabilitation  
6 agencies, market research firms and insurance companies.

7

## 8 **V. Rationale for Classification and Fees**

### 9 **A. Grounds For a Permanent Classification.**

10 There are several strong bases for the Postal Service’s request for a  
11 permanent weight averaging classification for nonletter-size BRM.

12

13 *Weight averaging significantly reduces the Postal Service’s costs.* When  
14 properly implemented, weight averaging is an efficient accounting method that  
15 significantly reduces the Postal Service’s costs of accounting for nonletter-size  
16 BRM. Currently, the Postal Service’s standard practice is to weigh and rate each  
17 piece of this nonletter-size BRM individually. For large volumes of nonletter-size  
18 BRM, weight averaging can reduce Postal Service costs and accounting time  
19 considerably.

20

21 *Weight averaging can save customers money.* Establishing a weight averaging  
22 classification will offer customers who receive large volumes of nonletter-size  
23 BRM an opportunity to enjoy reduced fees for their BRM. These lower fees

1 would be more in line with the reduced costs associated with weight averaging.  
2 In some cases, the time savings from implementing weight averaging also may  
3 provide the additional benefit of allowing customers to receive their BRM sooner  
4 in the day.

5

## 6 **B. Relationship of Fees to Costs.**

7 Witness Schenk has estimated the unit accounting cost for using weight  
8 averaging to be \$0.0054 per piece, and has estimated fixed costs of \$479.72 per  
9 month.<sup>6</sup> As reported above in Table 1, I propose a per-piece fee of \$0.01 and a  
10 monthly fee of \$600. The Postal Service's proposed fees more than adequately  
11 cover the attributable costs of counting and rating mail using the weight  
12 averaging methodology and make a reasonable contribution toward institutional  
13 costs. I discuss cost coverage further in Section VI.

14 We believe that the cost coverage produced by these fees is reasonable. In  
15 Section VI of my testimony, I examine the likely impacts of this new classification  
16 on the Postal Service's revenues and costs.

17

## 18 **C. Potential Savings to Customers.**

19 Based on the proposed fee structure, we estimate that any customer  
20 receiving at least 103,000 pieces of nonletter-size BRM per year will save money

---

<sup>6</sup> This assumes that the participating post office will sample 10 sacks per accounting period (rather than 20, as is being done during the experiment). To convert accounting period (AP) costs to monthly costs, multiply by 13/12: (\$442.82 per AP)\*(13 AP/12 mo.) = \$479.72/mo. Costs for the 10-sack sampling rate used here are taken from USPS-T-3, Table 4.

1 by opting to use the proposed classification.<sup>7</sup> The savings increase with BRM  
 2 volume: for example, a customer receiving 300,000 pieces of nonletter-size BRM  
 3 per year should save \$13,800 per year over what the customer would have paid  
 4 under the current fee structure.<sup>8</sup>

5

#### 6 **D. No Specific Minimum Volume Proposed.**

7 The Postal Service is not proposing that the new classification require  
 8 customers to have a specific minimum volume of nonletter-size BRM to take  
 9 advantage of the proposed fees. As shown above, customers receiving less  
 10 than 100,000 pieces per year of nonletter-size BRM should find it less costly to  
 11 use the existing fee structure. The Postal Service expects that few customers, if  
 12 any, receiving smaller volumes will opt for the weight averaging fees. It is  
 13 conceivable that smaller volume mailers might opt for the program because it  
 14 would enable them to receive their mail earlier in the day. The two-part, cost-  
 15 based fee structure ensures that there will be no adverse financial impact on the  
 16 Postal Service. Hence, the Postal Service sees no need to restrict access to the  
 17 proposed new fees by volume at this time.

18

#### 19 **E. Differences Between Proposed Permanent Fees and Experimental Fees.**

---

<sup>7</sup> The break-even volume (B) between the two fee structures is 102,857, calculated by solving the following equation:

$$\begin{aligned} \text{Current Fee Revenue} &= \text{Proposed Fee Revenue} \\ B * \$0.08 &= B * \$0.01 + \$600 * 12. \\ \text{Solving for B: } 0.07B &= 7200, \text{ or } B = 102,857. \end{aligned}$$

<sup>8</sup> A customer receiving 300,000 pieces per year would pay  $300,000 * \$0.08$ , or \$24,000 under the existing fee structure, and  $(300,000 * \$0.01 + 12 * \$600)$ , or \$10,200 using the proposed rates. This amounts to a saving of  $(\$24,000 - \$10,200)$  or \$13,800 per year.

Table 1 showed that the proposed permanent fees differ from the experimental fees. Both the per-piece fee and monthly fee are lower than the corresponding experimental fees. There are two principal reasons why the proposed fees are lower:

1. The experiment has revealed that it costs the Postal Service less to perform the weight averaging for nonletter-size BRM than we had initially estimated. With lower costs, we can afford to offer the service at an overall lower fee structure. See Subsection B, *Relationship of fees to costs*, for further discussion of this topic.

2. Also, as witness Fronk testified in Docket MC97-1 (USPS-T-3 at 22), the Postal Service proposed conservatively high fees for the experiment in order to err on the side of being sure that the fees covered the costs of weight averaging. After more than a year's experience in conducting the experiment, we are now more certain about the costs and can now propose a more fair and equitable match between the fees charged and underlying costs.

#### **F. Elimination of the Setup Fee.**

Our proposal does not include a setup/qualification fee similar to that implemented as part of the experimental fee structure. We have eliminated this fee for several reasons.

1       First, the experiment differs from the proposed permanent classification in  
2       several ways that affect setup costs. The experiment involved significant  
3       amounts of learning by doing, the costs of which were borne by the experiment  
4       participants exclusively. When implementing the permanent weight averaging  
5       classification, we will already have developed the necessary procedures and put  
6       them in place. We will be beyond the inefficient and costly learning process and  
7       expect to implement a permanent weight averaging classification in a manner  
8       more resembling the establishment of the typical mailing permit or advanced  
9       deposit account. Extraordinary setup costs are not ordinarily charged to mailers  
10      to cover the costs associated with establishing their accounts and permits. The  
11      experiment has led us to conclude that there is no compelling reason to  
12      distinguish BRM account holders whose mail is subject to weight averaging from  
13      other mailers in this respect.

14      Second, the Postal Service expects setup costs for a permanent weight  
15      averaging classification to be substantially lower than in the experiment, similar  
16      in magnitude to the administrative costs associated with qualifying mail or  
17      mailers for other services. These costs are now treated as overhead or  
18      institutional costs. The Postal Service decided to propose a setup fee for the  
19      experiment chiefly because we had preliminary evidence that the Parkersburg,  
20      WV site was having problems in reaching the target level of precision in  
21      estimating postage due using the reverse manifest method. We were concerned  
22      that the weight averaging sites might also experience similar site-specific



1 problems that could cause the Postal Service to incur significant unanticipated  
2 costs before the experimental method was implemented satisfactorily.

3 Our experience with the weight averaging experiment has allayed these  
4 concerns: we have set up the standard weight averaging method at four sites  
5 without significant setup problems. Based on this experience, we do not  
6 anticipate incurring any extraordinary site-specific setup costs when  
7 implementing weight-averaging accounting on a permanent basis. For this  
8 reason, there is no basis for treating these costs differently on a permanent basis  
9 than we do for the beneficiaries of other mailing permits or qualifiers for other  
10 classifications.

11 Third, because of the experiment there is now considerably less uncertainty  
12 surrounding weight averaging costs, hence the Postal Service no longer  
13 considers that it needs to collect a fixed setup/qualification fee to make sure its  
14 costs are adequately covered.

15

## 16 **VI. Impacts On Revenue, Cost, And Other Mail Classes**

### 17 **A. Revenue and Cost Impacts.**

18 Witness Ellard's testimony reports that our survey has uncovered ten customers  
19 receiving large amounts of nonletter-size BRM who have expressed an interest  
20 in the new classification and fees. These customers receive a total of 15.8  
21 million pieces of such mail per year at 11 different sites (USPS-T-2 at 8).

22 Exhibit USPS-4A shows the estimated revenue and cost impacts, if all of this  
23 mail were to switch from the current fees and manual processing to the new

1 weight averaging methodology and fees. It also presents two plausible  
2 alternative scenarios for purposes of illustration: one with more mail and more  
3 customers taking advantage of the new fees, and one with fewer customers and  
4 mail.<sup>9</sup> Exhibit USPS-4A shows that if all of the mail identified by witness Ellard  
5 switches to weight averaging (Scenario 1), the Postal Service's revenue would  
6 decline by approximately \$1.03 million. Scenario 1 also shows that using weight  
7 averaging to account for their BRM would save the Postal Service about \$1.13  
8 million in costs, when compared to manual accounting, offsetting the decline in  
9 revenue.<sup>10</sup> Whatever the offset, the revenue impact of the new classification  
10 remains a small part of the Postal Service's revenue requirement.

11 Exhibit USPS-4A also shows two alternative scenarios for comparison.  
12 These scenarios are not predictions, but represent hypothetical situations  
13 designed to illustrate the impacts on the Postal Service's revenues and costs, if  
14 customers and volumes were to turn out to be significantly higher than our  
15 market research indicates (Scenario 2), or if customers and mail volumes were to  
16 be significantly lower (Scenario 3).

17 In Scenario 2, I have assumed that 20 customers with 20 million pieces of  
18 nonletter-size BRM opt for the new fees. Exhibit USPS-4A shows that revenues  
19 decline by about \$1.26 million and costs decline by about \$1.40 million. In  
20 Scenario 3, I examine a hypothetical case in which only five customers receiving

---

<sup>9</sup> I believe that it is highly likely the number of customers and mail volumes identified by the market research will take advantage of the new permanent weight averaging fees. Nevertheless these two alternative scenarios are presented to show that the fees proposed are robust over a wide range of customers and mail volumes.

<sup>10</sup> To the extent that the sites and customers now participating in the experiment decide to continue to use the weight averaging methodology and fee structure, the revenue and cost impacts will be lower.

1 10 million pieces opt for the new fees. The revenue decline in this case is only  
2 approximately \$0.66 million, while costs fall approximately \$0.73 million.

3 In none of the three scenarios do the revenue reductions become excessive,  
4 and in each case there will be offsetting cost reductions because the Postal  
5 Service will not have to rate each piece individually. Additionally, the sensitivity  
6 analysis illustrated in Exhibit USPS-4A shows that, over a wide range of possible  
7 levels of use of the new fees, there is no significant financial impact on the  
8 Postal Service.

9  
10 *Cost coverage.* The Postal Service believes that Scenario 1 represents the most  
11 likely level of initial demand for the new fees. Exhibit USPS-4A shows that  
12 employing weight averaging to rate this mail and charging the proposed fees for  
13 this service produces annual revenues of \$237,200 and costs of \$148,643. This  
14 yields a cost coverage of  $(\$237,200/\$148,643)$ , or 160 percent which compares  
15 with the 155 percent cost coverage for all mail and services recommended by  
16 the Commission in Docket No. R97-1 (Op. Appendix G Schedule 1). The Postal  
17 Service believes that the proposed weight averaging fees produce a fair and  
18 equitable cost coverage.

19  
20 **B. Impacts on Other Postal Services.**

21 All BRM currently travels as First-Class Mail or Priority Mail. Establishing a  
22 new weight averaging classification will not change this requirement. Our survey  
23 has not uncovered any significant interest among mailers to convert non-BRM

1 mail to BRM in order to take advantage of the new fee structure (USPS-T-2 at 8).  
2 In light of these facts, we anticipate that any impacts of the new weight  
3 averaging classification on other mail classes will be negligible.

4

## 5 **VII. Classification Criteria**

6 Section 3623(c) of title 39 U.S.C. requires the Commission to make its  
7 decision on establishing a new classification in accordance with the following  
8 factors:

9

- 10 1. the establishment and maintenance of a fair and equitable  
11 classification system for all mail;
- 12
- 13 2. the relative value to the people of the kinds of mail matter entered into  
14 the postal system and the desirability and justification for special  
15 classifications and services of mail;
- 16
- 17 3. the importance of providing classifications with extremely high degrees  
18 of reliability and speed of delivery;
- 19
- 20 4. the importance of providing classifications which do not require an  
21 extremely high degree of reliability and speed of delivery;
- 22
- 23 5. the desirability of special classifications from the point of view of both  
24 the user and of the Postal Service; and
- 25
- 26 6. such other factors as the Commission may deem appropriate.
- 27

28 *Discussion.* The following discussion shows how the proposal is in accord with  
29 the Section 3623(c) factors, which are referenced below as Criteria 1 through 6.

30 On the basis of the Docket No. MC97-1 experiment, the Postal Service  
31 contemplates deploying the weight averaging methodology nationwide in post  
32 offices with participating recipients of large volumes of nonletter-size BRM. The

1 Postal Service expects weight averaging to lower BRM accounting costs in these  
2 locations. The proposal for a permanent weight averaging classification also  
3 offers recipients of nonletter-size BRM the opportunity to pay an accounting fee  
4 that is much more in line with Postal Service costs than if such mail had to pay  
5 the current eight-cent BRM accounting fee. The cost savings and the lower fees  
6 make the proposed classification desirable to both the Postal Service and the  
7 BRM recipients, furthering the goals of Criterion 5.

8 BRM offers a valuable service to businesses and their customers. It gives  
9 customers convenient access to products and services available through the  
10 mail. It also provides businesses with a more cost-effective means than prepaid  
11 postage envelopes to offer postage-paid communication to their customers. This  
12 is especially true in the case of nonletter-size BRM, which often varies in weight.  
13 To ensure fully postage-paid return mail for heavy as well as light pieces,  
14 businesses would have to offer envelopes with excess postage affixed, or set up  
15 arrangements to refund additional postage paid by customers. Either way would  
16 likely prove cumbersome and expensive. The Postal Service's new classification  
17 maintains the valuable advantages of BRM for both businesses and for their  
18 clients who send them nonletter-size mail, while reducing the costs of offering  
19 this service (Criterion 2 and Criterion 5).

20 All BRM travels as First-Class Mail or Priority Mail. For many companies the  
21 prompt turnaround of customer orders is of obvious business importance. By  
22 keeping the cost of mailing nonletter-size BRM down, the proposed new weight  
23 averaging classification would maintain the practical availability of a speedy

1 delivery option for businesses. The time saved by using weight averaging  
2 should also allow nonletter-size BRM recipients to receive their mail as  
3 expeditiously as possible (Criterion 3). Criterion 4 does not apply in this case.

4 Our proposal for a permanent weight averaging classification for nonletter-  
5 size BRM reflects a balanced consideration of all relevant criteria. Our proposal  
6 meets the needs of customers by providing a relatively low-cost option for  
7 receiving BRM. It compensates the Postal Service for the activities it undertakes  
8 in counting and rating this BRM, without adversely affecting the public,  
9 businesses, or other mail classes. In sum, our proposal is fair and equitable  
10 (Criterion 1).

## 13 **VIII. Pricing Criteria**

14 Section 3622(b) of title 39 U.S.C. requires the Commission to make its  
15 decision on changes in rates and fees for each class of mail or type of service in  
16 accordance with the following factors:

- 17 1. the establishment and maintenance of a fair and equitable schedule;
- 18 2. the value of the mail service actually provided each class or type of  
19 mail service to both the sender and the recipient, including but not  
20 limited to the collection, mode of transportation, and priority of delivery;
- 21 3. the requirement that each class of mail or type of mail service bear the  
22 direct and indirect postal costs attributable to that class or type plus  
23 that portion of all other costs of the Postal Service reasonably  
24 assignable to such class or type;
- 25
- 26
- 27
- 28

4. the effect of rate increases upon the general public, business mail users, and enterprises in the private sector of the economy engaged in the delivery of mail matter other than letters;
5. the available alternative means of sending and receiving letters and other mail matter at reasonable costs;
6. the degree of preparation of mail for delivery into the postal system performed by the mailer and its effect upon reducing costs to the Postal Service;
7. simplicity of structure for the entire schedule and simple, identifiable relationships between the rates or fees charged the various classes of mail for postal services;
8. the educational, cultural, scientific, and informational value to the recipient of mail matter; and
9. such other factors as the Commission deems appropriate.

*Discussion.* The following discussion shows how the proposal is in accord with the Section 3622(b) factors, which are referenced below as Criteria 1 through 9.

The Postal Service expects weight averaging to lower the costs of nonletter-size BRM accounting in locations where single customers receive large volumes of such mail. The proposal for a permanent weight averaging classification offers recipients of nonletter-size BRM the opportunity to pay fees that are much more in line with Postal Service accounting methods and costs than if such mail had to pay the otherwise applicable eight-cent BRM accounting fee.

As discussed in the Classification Criteria section, BRM offers a highly valuable service to both businesses and their customers. It gives customers convenient access to companies offering products and services available through the mail. It also provides businesses with a more cost-effective way than prepaid postage envelopes to serve their customers by offering them a

1 postage-paid mechanism to respond to business offers. The Postal Service's  
2 new classification maintains these valuable advantages of BRM for both  
3 businesses and for their clients who send them nonletter-size mail, while  
4 reducing the costs of offering this service (Criterion 2 and Criterion 5).

5 In accordance with Criterion 3, the proposed fees for the weight averaging  
6 classification cover the costs for the service which are estimated by witness  
7 Schenk (USPS-T-3). The proposed fees also meet Criterion 4. The fee  
8 structure is not expected to adversely affect the general public or business  
9 mailers. Establishment of weight averaging accounting fees also is not expected  
10 to adversely affect postal competitors.

11 There are a number of non-postal alternatives for transmitting  
12 communications and other matter commonly sent by letter-size BRM: toll-free  
13 telephone numbers, fax, e-mail, wire transfers, and credit cards to name several.  
14 These alternative means do not appear relevant for most of the material currently  
15 or potentially sent as nonletter-size BRM: exposed film, large documents,  
16 photographs, videos, and similar materials. There are few, if any, alternatives  
17 that allow the mailer to send this kind of nonletter-size matter free of charge, and  
18 none offer a price that is similar to the postage and fees paid by the typical  
19 nonletter-size BRM piece.<sup>11</sup> Establishing this new BRM classification is expected  
20 to have negligible impact on available alternative means of sending nonletter-  
21 size BRM (Criterion 5).

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<sup>11</sup> Some express and courier services allow the sender to charge the cost of sending an item to the recipient's billing number. These high-priced expedited delivery services do not appear to represent a realistic alternative to BRM for most recipients of nonletter-size BRM.



1 Criterion 6 does not appear to be relevant in this case.

2 Criterion 7, in and of itself, would appear to suggest that the number of rate  
3 and fee alternatives be kept to a minimum. On the other hand, the second part  
4 of Criterion 7 concerns itself with maintaining identifiable relationships between  
5 rates or fees for various postal products, suggesting more, rather than fewer,  
6 rates and fees. A higher degree of complexity is not unusual for classification  
7 and fee schedules likely to be used by sophisticated businesses or other  
8 institutional customers. By definition, BRM is a service of this type. In this  
9 instance, pursuit of simplicity needs to be balanced with recognition of cost  
10 savings and the goal of maintaining more complex fee relationships that are  
11 identifiable. Bulk BRM recipients responsible for maintaining advance deposit  
12 accounts tend to be relatively sophisticated mailers and should not regard a new  
13 line in the BRM classification and fee schedule as inordinately complex.

14 BRM is not a primary means for the transfer of information normally  
15 considered to be of scientific, educational, or cultural content (Criterion 8).

16 Our proposed nonletter-size BRM weight averaging fees reflect a balanced  
17 consideration of all relevant criteria. Our proposal meets the needs of customers  
18 by providing a relatively low-cost option for receiving BRM, and compensates the  
19 Postal Service for the activities it undertakes in counting and rating this BRM,  
20 without adversely affecting the public, businesses, or other mail classes. In sum,  
21 our proposal is fair and equitable (Criterion 1).

## Existing and Proposed DMCS Language

930 **PAYMENT ALTERNATIVES**931 **BUSINESS REPLY MAIL**931.1 **Definitions**

931.11 Business reply mail is a service whereby business reply cards, envelopes, cartons and labels may be distributed by or for a business reply distributor for use by mailers for sending First-Class Mail without prepayment of postage to an address chosen by the distributor. A distributor is the holder of a business reply license.

931.12 A business reply mail piece is nonletter-size for purposes of this section if it meets addressing and other preparation requirements, but does not meet the machinability requirements specified by the Postal Service for mechanized or automated letter sortation.

~~This provision expires June 7, 1999.~~

931.2 **Description of Service**

931.21 The distributor guarantees payment on delivery of postage and fees for all returned business reply mail. Any distributor of business reply cards, envelopes, cartons and labels under any one license for return to several addresses guarantees to pay postage and fees on any returns refused by any such addressee.

931.3 **Requirements of the Mailer**

931.31 Business reply cards, envelopes, cartons and labels must be preaddressed and bear business reply markings.

931.32 Handwriting, typewriting or handstamping are not acceptable methods of preaddressing or marking business reply cards, envelopes, cartons, or labels.

931.4 **Fees**

931.41 The fees for business reply mail are set forth in Fee Schedule 931.

931.42 To qualify as an active business reply mail advance deposit trust account, the account must be used solely for business reply mail and contain sufficient postage and fees due for returned business reply mail.

931.43 An accounting fee as set forth in Fee Schedule 931 must be paid each year for each advance deposit business reply account at each facility where the mail is to be returned.

**931.5 ~~Experimental Reverse Manifest Fees~~**

~~931.51 A set up/qualification fee as set forth in Fee Schedule 931 must be paid by each business reply mail advance deposit trust account holder at each destination postal facility at which it applies to receive nonletter size business reply mail for which the postage and fees will be accounted for through a reverse manifest method approved by the Postal Service for determining and verifying postage.~~

~~A distributor must pay this fee for each business reply mail advance deposit trust account for which participation in the nonletter size business reply mail experiment is requested.~~

~~This provision expires June 7, 1999.~~

~~931.52 A nonletter size reverse manifest monthly fee as set forth in Fee Schedule 931 must be paid each month during which the distributor's reverse manifest account is active.~~

~~This fee applies to the (no more than) 10 advance deposit account holders which are selected by the Postal Service to participate in the reverse manifest nonletter size business reply mail experiment and which utilize reverse manifest accounting methods approved by the Postal Service for determining and verifying postage and fees.~~

~~This provision expires June 7, 1999.~~

**931.6 ~~Experimental~~Nonletter-Size Weight Averaging Fees**

~~931.61 A set up/qualification fee as set forth in Fee Schedule 931 must be paid by each business reply mail advance deposit trust account holder at each destination postal facility at which it applies to receive nonletter size business reply mail for which the postage and fees will be accounted for through a weight averaging method approved by the Postal Service for determining and verifying postage.~~

~~A distributor must pay this fee for each business reply mail advance deposit trust account for which participation in the nonletter size business reply mail experiment is requested.~~

~~This provision expires June 7, 1999.~~

~~931.62~~ A nonletter-size weight averaging monthly fee as set forth in Fee Schedule 931 must be paid each month during which the distributor's weight averaging account is active.

~~This fee applies to the (no more than) 10 advance deposit account holders which are selected by the Postal Service to participate in the weight averaging nonletter-size business reply mail experiment.~~

~~This provision expires June 7, 1999.~~

## 931.7 **Authorizations and Licenses**

931.71 In order to distribute business reply cards, envelopes, cartons or labels, the distributor must obtain a license or licenses from the Postal Service and pay the appropriate fee as set forth in Fee Schedule 931.

931.72 Except as provided in section 931.73, the license to distribute business reply cards, envelopes, cartons, or labels must be obtained at each office from which the mail is offered for delivery.

931.73 If the business reply mail is to be distributed from a central office to be returned to branches or dealers in other cities, one license obtained from the post office where the central office is located may be used to cover all business reply mail.

931.74 The license to mail business reply mail may be canceled for failure to pay business reply postage and fees when due, and for distributing business reply cards or envelopes that do not conform to prescribed form, style or size.

931.75 Authorization to pay ~~experimental~~ nonletter-size weight averaging business reply mail fees as set forth in Fee Schedule 931 may be canceled for failure of a business reply mail advance deposit trust account holder to meet the standards specified by the Postal Service for the ~~applicable reverse manifest or~~ weight averaging accounting method.

~~This provision expires June 7, 1999.~~

## Existing and Proposed Fee Schedule 931 Language

## FEE SCHEDULE 931

## BUSINESS REPLY MAIL

	Fee
Active business reply advance deposit account:	
Per piece	
Qualified	\$0.05
<del>Nonletter-size, using reverse manifest (experimental)</del>	<del>\$0.02</del>
<del>Nonletter-size, using weight averaging (experimental)</del>	<del>\$0.03</del>
<del>Nonletter-size, using weight averaging</del>	<del>\$0.01</del>
Other	\$0.08
Payment of postage due charges if active business reply mail advance deposit account not used:	
Per piece	\$0.30
Annual License and Accounting Fees:	
Accounting Fee for Advance Deposit Account	\$300
Permit fee (with or without Advance Deposit Account)	\$100
Monthly Fees for customers using <del>a reverse manifest</del> <del>or weight averaging</del> for nonletter-size business reply	
<del>Nonletter-size, using reverse manifest (experimental)</del>	<del>\$1,000</del>
<del>Nonletter-size, using weight averaging (experimental)</del>	<del>\$3,000</del>
<del>Nonletter-size, using weight averaging</del>	<del>\$600</del>
Set up/Qualification fee for customers using <del>a reverse</del> <del>manifest or weight averaging</del> for nonletter-size business reply	
<del>Nonletter-size, using reverse manifest (experimental)</del>	<del>\$1,000</del>
<del>Nonletter-size, using weight averaging (experimental)</del>	<del>\$3,000</del>

~~1 Experimental per piece, monthly, and set up/qualification fees are applicable only to participants selected by the Postal Service for the nonletter-size business reply mail experiment. The experimental fees expire June 7, 1999.~~

**Docket No. MC99-2 Exhibit USPS-4A: Revenue and Cost Impacts**

		Number of Sites	Eligible BRM Volume (Millions/Yr.)	Annual Revenues			Annual Costs		
				Proposed Fees	Current Fees	Change	Proposed Methodology	Current Methodology	Change
		[1]	[2]	[3]	[4]	[5]	[6]	[7]	[8]
Scenario 1: Survey-Based Customers and Volume		11	15,800,000	\$ 237,200	\$ 1,264,000	\$ (1,026,800)	\$ 148,643	\$ 1,262,960	\$ (1,134,317)
Scenario 2: Higher Demand for the New Fees		20	20,000,000	\$ 344,000	\$ 1,600,000	\$ (1,256,000)	\$ 223,133	\$ 1,624,000	\$ (1,400,867)
Scenario 3: Lower Demand for the New Fees		5	10,000,000	\$ 136,000	\$ 800,000	\$ (664,000)	\$ 82,783	\$ 812,000	\$ (729,217)
Assumptions									
Piece-by-Piece Fees and Costs									
Per Piece Fee	\$ 0.08	[9]							
Per Piece Costs	\$ 0.0812	[10]							
Weight Averaging Fees and Costs									
Per Piece Fee	\$ 0.01	[11]							
Monthly Fee	\$ 800.00	[12]							
Per Piece Cost	\$ 0.0054	[13]							
Monthly Cost	\$ 479.72	[14]							

**Notes**

- [1] Scenario 1: USPS-T-2, page 8  
Scenario 2: Assumed values  
Scenario 3: Assumed values
- [2] Scenario 1: USPS-T-2, page 8  
Scenario 2: Assumed values  
Scenario 3: Assumed values
- [3]  $[1] * [12] * 12 + [2] * [11]$
- [4]  $[2] * [9]$
- [5]  $[3] - [4]$
- [6]  $[1] * [14] * 12 + [2] * [13]$
- [7]  $[2] * [10]$
- [8]  $[6] - [7]$
- [9] Regular BRM Advance Deposit per piece fee (DMCS Fee Schedule 931)
- [10] Estimated by Leslie Schenk using methodology of R97-1 Exhibit USPS-27D, revised 3/4/99
- [11] USPS Proposal: USPS-T-4, page 13
- [12] USPS Proposal: USPS-T-4, page 13
- [13] USPS-T-4, page 16
- [14] USPS-T-4, page 16